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No. 98-272

IN THE SUPREME COURT OF THE UNITED STATES OCTOBER TERM, 1997

NORFOLK SOUTHERN CORPORATION,
and affiliated companies;
NORFOLK & WESTERN RAILWAY COMPANY,
and affiliated companies,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

AMICUS CURIAE BRIEF SUBMITTED BY INSTITUTE OF INTERNATIONAL CONTAINER LESSORS IN SUPPORT OF PETITIONERS

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15 pp

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES..... ii

STATEMENT OF INTEREST OF *AMICUS CURIAE*..... 1

ARGUMENT OF IICL..... 3

A. *Relevant Legal Interpretations, Unaddressed by the Fourth Circuit Decision, Demonstrate that Containers Need Not Touch the United States at Least Annually to Qualify*..... 3

B. *Retroactive IRS Interpretation Had A Widespread, Harsh and Unfair Impact on the Industry and Was an Abuse of Discretion Under I.R.C. Section 7805(b)*..... 7

CONCLUSION..... 11

TABLE OF AUTHORITIES

CASES

Page

Automobile Club of Michigan v. Commissioner, 353 U.S. 180 (1957)..... 10

Baker v. United States, 748 F.2d 1465 (11th Cir. 1984)..... 10

Bird v. United States, 187 U.S. 118, 124 (1902)..... 6

Central Illinois Public Service Co. v. Commissioner, 435 U.S. 21 (1978)..... 10

LeCroy Research Systems Corp. v. Commissioner, 751 F.2d 123 (2d Cir. 1984)..... 10

LeSavoy Foundation v. Commissioner, 238 F.2d 589 (3rd Cir. 1956)..... 10

McCarty v. Commissioner, 53 T.C.M. 854 (1987)..... 5

Pacific Far East Lines, Inc. v. Commissioner, 544 F.2d 478, 484 (Ct. Cl. 1976)..... 7

United States v. Carlton, 512 U.S. 26 (1994)..... 9

United States v. Darusmont, 449 U.S. 292 (1981)..... 9

STATUTES

Page

I.R.C. § 48(a)(2)(A) 3
I.R.C. § 48(a)(2)(B)(i) 4
I.R.C. § 48(a)(2)(B)(iii) 4
I.R.C. § 48(a)(2)(B)(iv) 5
I.R.C. § 48(a)(2)(B)(v) 3
I.R.C. § 168(g)(4) 7
I.R.C. § 7805(b) 7, 10

LEGISLATIVE MATERIALS

H.R. Rep. No. 1447, 87th Cong., 2d Sess. (1962), *reprinted in* 1962-3 C.B. 405 ..... 4, 5

TREASURY REGULATIONS, REVENUE RULINGS AND REVENUE PROCEDURES

Treas. Reg. § 1.48-1(g)(2)(iii) 4

Rev. Rul. 69-509, 1969-2 C.B. 3 4
Rev. Rul. 73-367, 1973-2 C.B. 8 4
Rev. Rul. 90-9, 1990-1 C.B. 46 ..... 8, 9

Rev. Proc. 90-10, 1990-1 C.B. 467 ..... 6, 9

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The Institute of International Container Lessors ("IICL") is the trade association of U.S. and foreign lessors of shipping cargo containers and chassis used in containerized shipping. IICL members own approximately 90 percent of the world's leased container fleet and over 40 percent of the world's total container fleet of over 7 million containers. IICL is active in worldwide technical, instructional, and similar activities related to containers.

If the Court does not grant the petition for writ of certiorari, it will become necessary for the issue to continue to be litigated in other courts at great expense, with unnecessary and continuing uncertainty for years to come in respect of an extremely important issue to the industry. This case gives the Court the opportunity to correct an incorrect interpretation of law, and an abuse of discretion, by the Internal Revenue Service ("IRS") that has had a widespread, harsh, and unfair impact on the industry.

IICL would like to call to the attention of the Court two important matters.

(1) The Fourth Circuit Court of Appeals (the "Fourth Circuit") ***did not even address*** directly relevant legal authorities -- namely, legal interpretations of analogous statutory exceptions for other equipment (e.g., aircraft and vessels). These analogous other interpretations demonstrate that the Fourth Circuit erred in interpreting the statute restrictively so as to require cargo containers to "touch" the United States once per year in order to qualify for the investment tax credit ("ITC") and accelerated depreciation.

(2) The relevant 1990 legal interpretation by the IRS, retroactive for up to ***28 years***, was made after years of explicit and implicit acceptance by the IRS of the interpretation upon which IICL members relied in negotiating for the purchase and lease of billions of dollars of fungible, nontraceable containers that are important to world trade. The retroactive 1990 interpretation was so extraordinarily harsh, unfair, and impossible to comply with as to constitute an impermissible abuse of discretion by the IRS. The detrimental impact on IICL members goes far beyond the impact on the Petitioners or the real party in interest, Flexi-Van Leasing, Inc. ("Flexi-Van"), both for ITC purposes (pre-1987) and accelerated depreciation purposes (through today).

ARGUMENT OF IICL[1]

A. *Relevant Legal Interpretations, Unaddressed by the Fourth Circuit Decision, Demonstrate that Containers Need Not Touch the United States at Least Annually to Qualify*

Section 48(a)(2)(B)(v) of the Internal Revenue Code of 1954,[2] which provides an exception for cargo containers of a U.S. person used in the transportation of property to and from the United States ("Container Exception") from the general requirement of I.R.C. Section 48(a)(2)(A) that property eligible for the ITC be used predominantly inside the United States ("Predominant U.S. Use Requirement"), is properly interpreted by analogy to interpretations of the statutory exceptions from the Predominant U.S. Use Requirement for other similar equipment (e.g., aircraft or

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[1] IICL's members are: Carlisle Leasing International Co., Greenwich, CT; Container Applications International, Inc., San Francisco, CA; Cronos Containers Limited, Berkshire, England; Flexi-Van, Kenilworth, NJ; Florens Container Services (U.S.) Ltd., San Bruno, CA; GE SeaCo SRL, Bridgetown, Barbados; Interpool Limited, New York, NY; Textainer Equipment Management (U.S.), Ltd., San Francisco, CA; Trac Lease, Inc., New York, NY; Transamerica Leasing Inc., Purchase, NY; Triton Container International Ltd., San Francisco, CA; and XTRA International, San Francisco, CA. Only IICL members (other than Transamerica Leasing Inc.) contributed financially to the preparation of this Brief. While Flexi-Van, the real party in interest, is an IICL member (and thus a pro rata portion of its IICL dues will contribute financially to the Brief), neither counsel for a party, nor Flexi-Van, authored this brief in whole or in part.

The consent of counsel for the petitioners to file this brief has been obtained. The consent of the Solicitor General of the United States, counsel for the respondent, has also been obtained.

[2] References to "I.R.C." are to the Internal Revenue Code of 1954 and/or 1986, as amended and in effect for the year that the context requires.

vessels). The analogous interpretations demonstrate that Congress did *not* intend to require a container to "touch" the United States at least once per year.

I.R.C. Section 48(a)(2)(B)(i) provides an exception from the Predominant U.S. Use Requirement for aircraft registered with the FAA that are "operated to and from the United States." An aircraft which makes foreign-to-foreign flights can qualify for the exception so long as the aircraft returns to the United States "with some degree of frequency." H.R. Rep. No. 1447, 87th Cong., 2d Sess. (1962), *reprinted in* 1962-3 C.B. 405, 517 ("House Report 1447"). The IRS has ruled that an aircraft that returns to the United States at least once every 14 days satisfies this test. Rev. Rul. 73-367, 1973-2 C.B. 8. In 1973, when Rev. Rul. 73-367 was issued, an aircraft in international service by a U.S. carrier made an average of about 39 trips in each 14 day period. *Tax Court Supplemental Stipulation of Facts,* ¶136. Thus, only about one out of 39 (or 2.56 percent) of these trips had to "touch" the United States. If such a test were applied to containers by analogy (i.e., requiring only 2.56 percent of their trips to touch the United States), a container, which typically makes five to six trips per year, would need to touch the United States only about *once every six or seven years*.

I.R.C. Section 48(a)(2)(B)(iii) provides an exception from the Predominant U.S. Use Requirement for vessels documented under the laws of the United States which are "operated in the foreign or domestic commerce of the United States." The IRS has ruled that a vessel *never* has to come to the United States to qualify for such exception as long as the vessel is properly documented by the Coast Guard for use in foreign trade, coastwise trade or the fisheries. Treas. Reg. § 1.48-1(g)(2)(iii); Rev. Rul. 69-

509, 1969-2 C.B. 3.[3] If the vessel standard were applied to containers, a container would *never* have to come to the United States. The fact that vessels need never touch the United States demonstrates that, contrary to the Fourth Circuit's view, there is no minimum annual U.S. "touch" requirement for property to be eligible for ITC and accelerated depreciation.

The legal standard applicable to the Container Exception should be even broader than the standards applicable to vessels and aircraft. Vessels and aircraft carry logs and are far more easily traced than are containers, for which no logs exist. Container lessors are not in control of the use of their containers by shipping lines and thus container lessors cannot trace the physical location of containers. Further, virtually no shipping company is able to trace containers in a manner that would satisfy a one U.S. touch per year test. This inability to trace containers was true in 1962, when the ITC was enacted by Congress, in 1971, when it was reenacted, in 1981, when accelerated depreciation was enacted by Congress using the same standard, and in 1986, when the ITC was repealed and modified accelerated depreciation using the same standard was enacted.

Containers also move very slowly and make significantly fewer trips per year than vessels and far fewer trips than aircraft.[4] A requirement that a container must

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[3] The Tax Court, in a memorandum decision, has suggested that the vessels with a different documentation must return to the United States "with some degree of frequency." McCarty v. Commissioner, 53 T.C.M. 854 (1987). Motor vehicles, which must be operated "to and from" the United States to qualify for the I.R.C. Section 48(a)(2)(B)(iv) exception, must return to the United States only with "some degree of frequency." House Report 1447 at 518.

[4] Containers make fewer trips than vessels because once a ship delivers a container to port, the container typically travels inland and

"touch" the United States once per year thus would be proportionately far harder for a container to meet than a vessel or aircraft.

For these reasons, the Container Exception should be interpreted *more broadly* than the analogous exceptions to the Predominant U.S. Use Requirement for other property, such as aircraft or vessels. Nevertheless, the Fourth Circuit decision would impose a *stricter* requirement -- one touch per year -- than that imposed on aircraft and vessels which are easily traced and which make a far greater number of trips per year than do containers. Congress could not have intended such a requirement, nor could it have intended one that is impossible to satisfy. The IRS itself has stated that "separate tracing is usually impracticable." Rev. Proc. 90-10, 1990-1 C.B. 467, 467. Even if the location of containers could be traced practicably, a one U.S. touch per year test, given the few number of trips per year made by containers, would mean that most containers placed in service in the last half of the year could not qualify, a result Congress could not have intended.[5]

The statute should be construed in a manner which effectuates, not frustrates, its purpose. Bird v. United States, 187 U.S. 118, 124 (1902). Further, as the ITC and accelerated depreciation are tax incentives to encourage investment, the statute should be construed liberally to

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does not return to the port for reloading until after delivery is made at the inland destination. Further, a container may have to be repositioned to another location to await the loading of new cargo. A ship, however, will leave the port within a day or two after arrival.

[5] Further, containers are fungible and interchangeable. Shipping companies do not distinguish between leased and owned containers. As fungible property, it should be irrelevant whether, by the luck of the draw, any particular container comes to the United States in a given year.

effectuate its purposes. Pacific Far East Lines, Inc. v. United States, 544 F.2d 478, 484 (Ct. Cl. 1976). Instead, the interpretation of the Fourth Circuit would make the Container Exception a substantial nullity because of the impossibility of proof of compliance. The Container Exception should apply whenever a container is, or is reasonably expected to be, leased to a shipping line with U.S. trade routes.[6]

B. *Retroactive IRS Interpretation Had A Widespread, Harsh and Unfair Impact on the Industry and Was an Abuse of Discretion Under I.R.C. Section 7805(b)*

The impact of the Fourth Circuit decision is far wider than that on either the Petitioners or Flexi-Van (the real party in interest). While this case involves ITC and accelerated depreciation for 1981-1985, the precedent affects the entire container leasing industry for open taxable years as far back as 1962 through 1986, when the ITC was repealed, and after 1986 because the Container Exception is still relevant for accelerated depreciation purposes. See I.R.C. Section 168(g)(4). Flexi-Van is no longer in the container leasing business (it leases only chassis) and the Petitioners only leased containers briefly as so-called "safe harbor" lessors during 1981-1983. Prior to 1990, the container leasing industry entered into billions of dollars of container leases in which the lease rates were negotiated based upon what it believed, and continues to believe, was a correct interpretation of the Container Exception.

Container lessors always claimed the Container Exception on their income tax returns and the industry's interpretation was known by the IRS. During the 1960s

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[6] As of 1981, 50 percent of all worldwide container traffic was to or from the United States, based on worldwide port handlings. *Tax Court Supplemental Stipulation of Facts*, ¶ 147.

and 1970s, the IRS never challenged the eligibility for the Container Exception of any container owned by any IICL member, despite the fact that ITC and accelerated depreciation for containers were major items on their returns. In 1980, the IRS opened a revenue ruling project to issue published guidance on the Container Exception. In 1981, the IRS contacted IICL and met with them in early 1982. IICL informed the IRS at that time that container lessors did not maintain records tracing the actual use of containers by the shipping companies, that IICL did not believe that the Container Exception required such records, and that any requirement to maintain such records would be difficult if not to impossible to comply with given the extremely large number of containers and shipping companies involved and the inability to trace the location of containers. After receiving an IICL memorandum confirming these points, the IRS closed the revenue ruling project in 1982 *without amending the regulations or issuing any ruling, or in any way even remotely suggesting a one U.S. touch requirement.*

In reliance upon what IICL continues to believe to be the correct interpretation of law, as well as explicit IRS knowledge of that interpretation, the closing of the revenue ruling project, and no IRS examination activity on the issue, the industry continued to enter into billions of dollars of leasing transactions with lease rates at a lower rate than they otherwise would have been had the industry had even an inkling that the IRS view was different from the industry's view.

It is IICL's understanding that, in late 1987, only as a result of a request for technical advice from a taxpayer in an examination, IRS National Office looked at the issue again and subsequently opened a new revenue ruling project that ultimately resulted in Rev. Rul. 90-9, 1990-1

C.B. 46. Rev. Rul. 90-9 contained a new IRS interpretation that a taxpayer was required to document whether each container was actually used substantially in the direct transportation of property to or from the United States during the taxable year and each subsequent year.

Contrary to the Fourth Circuit's conclusion, Rev. Rul. 90-9 came as a total shock to the industry. It required tracing that was *essentially impossible*. The IRS chose to apply it retroactively for up to 28 years. It was done at a time and in a fashion that the industry could not comply with it prospectively -- which the IRS acknowledged -- much less retroactively. It was done when the industry was bound by lease agreements with lower rates than it otherwise would have negotiated had the Container Exception not applied, with resulting lost revenues that could never be recovered by lessors in order to pay taxes.

Even if the IRS interpretation were valid,[7] the retroactive application of such interpretation is extraordinarily harsh and unfair in circumstances where (1) the IRS had explicit knowledge of the industry's interpretation (both by the IRS National Office and in the field), (2) the IRS closed a revenue ruling project on the very issue in 1982 after receiving a memorandum from IICL, (3) IRS examining agents accepted the industry's interpretation for over 25 years, and (4) the IRS standard was *impossible to comply with* -- the IRS itself stated that its standard is usually impracticable to comply with.[8]

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[7] IICL believes it is not. Because IICL believes that Congress did not require a one U.S. touch per year test, as discussed above, IICL does not believe that even Congress could constitutionally change the Container Exception with the extent of retroactivity asserted by the IRS. *See* United States v. Carlton, 512 U.S. 26 (1994); United States v. Darusmont, 449 U.S. 292, 297 (1981).

[8] Rev. Proc. 90-10, 1990-1 C.B. 467, 467.

Retroactive application of the interpretation in such circumstances is an impermissible abuse of whatever discretion the IRS may have had in this regard under I.R.C. Section 7805(b). See Automobile Club of Michigan v. Commissioner, 353 U.S. 180 (1957); Central Illinois Public Service Co. v. United States, 435 U.S. 21 (1978); LeSavoy Foundation v. Commissioner, 238 F.2d 589 (3rd Cir. 1956); Baker v. United States, 748 F. 2d 1465 (11th Cir. 1984); LeCroy Research Systems Corp. v. Commissioner, 751 F.2d 123 (2d Cir. 1984).

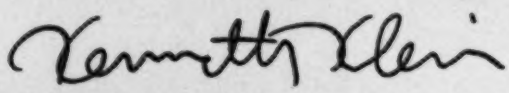
Further, the up to 28 year retroactive application of the 1990 IRS interpretation has resulted in uneven and disparate treatment among members of IICL because some members' taxable years were closed, others were not, and others received favorable settlements from the IRS.

This issue is of such importance to the financial health of the industry that it will have to continue to be litigated by members of the industry at great expense if the Court does not grant the Petitioners' petition for writ of certiorari. Now is the time, after 36 years, to resolve this issue with certainty.

CONCLUSION

For the foregoing reasons, IICL urges the Court to grant the petition for writ of certiorari.

Respectfully submitted,



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